

**THE COMMONWEALTH OF MASSACHUSETTS  
DEPARTMENT OF TELECOMMUNICATIONS  
AND ENERGY**

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**Risk-Management Techniques**

**to**

**Mitigate Natural Gas Price Volatility**

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**D.T.E. 01-100**

**COMMENTS OF KEYSPAN ENERGY DELIVERY NEW ENGLAND**

**I. Introduction**

On December 4, 2001, the Department of Telecommunications and Energy (“Department”) issued an Order opening a Notice of Inquiry into the appropriateness of the use of risk-management techniques to mitigate natural gas price volatility. In that Order, the Department requested comments on specific questions. Responses to those questions are provided herein, jointly, by Boston Gas Company, Colonial Gas Company, and Essex Gas Company, each doing business as KeySpan Energy Delivery New England (“KeySpan”).

A risk-management program could be undertaken to temper the price volatility of natural gas supply. If the Department were to decide that a risk-management program should be a component of a utility’s management of natural gas supply, it could encourage utility consideration of these programs by (i) acknowledging that it is reasonable for gas utilities to address price stability as part of their management of gas supply portfolios, and (ii) where a gas utility chooses to pursue a risk-management program for its gas supply, providing a procedure for annually reviewing these proposals

for the coming year to address the reasonableness of their approach. However, KeySpan cautions that, whereas such programs provide the advantage of minimizing price volatility, there may be costs associated with such programs, and that a program of price stabilization may result in gas supply prices being higher or lower than they otherwise would have been. It is these factors that could be weighed, and addressed to the Department, each year before a price stabilization program is implemented.

## **II. Responses to Department Questions:**

### **1. Should Massachusetts gas utilities be allowed or required to implement a risk-management program to mitigate price volatility for gas customers?**

The Commission could consider whether it is appropriate, in light of changing market conditions, to continue to rely solely on one pricing mechanism for the monthly flowing supplies. The past few years have seen a dramatic increase in the volatility of energy commodities, and the customer's bill has reflected this swing in prices. Gas utilities in Massachusetts currently utilize one pricing mechanism for their monthly flowing supplies. Monthly prices are established based on one day of the NYMEX futures gas contract. This single monthly price has been accepted as representing the best price at which utilities should purchase their gas supply. Price-volatility moderation, through a risk-management program, would be an additional objective of a utility's gas supply portfolio management. However, price-moderation could involve some costs and can be expected at times to result in prices that are higher than they would have been without the risk-management program.

To some extent the gas utilities currently have a risk-management program in the form of storage. A part of the winter gas price is fixed prior to the winter season by injecting gas into storage at summertime prices. A risk-management program for the flowing supplies could just be an extension of this accepted practice. The price portfolio of a risk-management program could be as simple as fixing the price of a small volume of gas over a period of time or a more complicated portfolio of fixed prices and hedging instruments.

**2. How will risk-management by LDCs affect gas unbundling and customer choice in Massachusetts?**

A risk-management program should have no effect on gas unbundling and customer choice. The same risk-management tools available to utilities are available to third-party suppliers.

**3. Should gas utilities be limited to specific types of risk-management instruments? If so, what types?**

The cost-exposure the risk-management instrument places on the utility customer should be limited, not the type of instrument. To say that under no circumstances should one particular type of risk-management tool be used would unnecessarily be limiting opportunities. Each year, the LDC that is proposing to adopt a risk-management program for gas supply should submit a description of that program to the Department staff explaining the risk management plan and the types of risk-management tools it intends on using. The Department should issue

an order on the reasonableness of the parameters within which the LDC will operate.

**4. Should there be a percentage volume of gas that LDCs would be allowed to hedge?**

A utility may propose that the parameters within which it will operate its risk-management program, as addressed in its annual risk-management proposal, will include volume and time limitations. The Department should then consider the appropriateness of volume and time limitations within the context of that overall risk-management plan.

**5. What should the core objectives of a hedging program be (e.g., least cost, price stability)?**

The core objectives should be to balance least cost with price stability. The risk-management program should seek to provide some price stabilization without unduly impacting cost.

Although lowest cost is an objective, price stabilization may not achieve the lowest cost compared to short-term market prices. Price stabilization programs could result in a price that is stabilized lower than what prices otherwise would have turned out to be under the current one price pricing mechanism for flowing supplies, or higher. What will achieve the lowest cost is not known until after the fact. It should not be the objective of a gas utility price stabilization program to participate in price speculation, i.e., to “outsmart” the market.

**6. How will the Department assess risk-management programs? What benchmarks should be used to measure a risk management program?**

A risk-management program should be measured by the reasonableness of its plan to accomplish the dual objectives of price minimization and price stability before that plan is implemented. It should not be subject to an after-the-fact review based on the performance of the risk-management program compared to the short-term prices in the marketplace.

**7. What standard of review should the Department apply to the utilities' initial risk-management program?**

Each year, the interested gas utility should submit its proposed risk-management program. This program should include both a short-term (coming winter and injection season) and long term (multi-year) plans. The Department could review each program to determine whether it is reasonably designed to accomplish the dual objectives of price minimization and stability.

**8. What types of costs are associated with risk-management? Should LDCs be allowed to recover these costs? If so, please explain how this mechanism should be structured.**

Risk-management instruments are available in the marketplace. Not all risk-management instruments impose costs; a "costless collar" brackets prices between a high price level and a low price level but does not involve an out-of-pocket expense. However, other instruments do have a cost. The costs of these instruments, purchased on behalf of the customers, should be charged to

customers as a part of their gas supply costs. They should be reflected in the CGAC in the same manner as other gas supply costs.

**9. Should an incentive mechanism be used in conjunction with a risk-management program? If so, please explain how this mechanism should be structured.**

No. The Department may determine that it is reasonable for gas utilities to consider price stability as part of their management of gas supply; however, the gas utility that engages in a risk-management program, as a part of its supply service obligation for its sales customers, should not be required to be in the *business* of risk-management by having an incentive mechanism imposed upon it, any more than utilities are required to be in the gas supply business for profit.

### **III. Conclusion**

KeySpan appreciates the opportunity to offer these comments in response to the Department's questions. Please do not hesitate to contact the undersigned should you require further information.

Respectfully submitted,

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